



# Financing and Budgeting

FOR EARLY CARE AND EDUCATION FACILITIES



THE NATIONAL CENTER ON  
Program Management  
and Fiscal Operations





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# INTRODUCTION

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Developing a new early care and education facility—or making significant improvements to an existing one—invariably involves raising capital to complete the project. Finding the necessary resources can be the most challenging part of this process. Nonetheless, with determination, creativity, and some luck, you should be able to raise enough capital to create the type of physical environment that meets your needs. As you start thinking about the money your organization will need to raise and the resources it will need to gather, keep in mind that the effort will invariably take longer and cost more than you initially think.

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This document explains how to determine the cost of a facility project and how to prepare a budget. It then describes potential sources of funding that early childhood programs have successfully used to locate capital, and it explains strategies for securing that capital. If you use any Head Start funds for your project, you must follow the requirements outlined in 45 CFR Part 1309, the section of the Head Start Program Performance Standards containing facilities regulations, which is available at <http://eclkc.ohs.acf.hhs.gov/hslc/standards/hspss/1309>.

Many factors influence the cost of planning a new facility. For example, for a new site, will the building or land be leased or purchased? Does the project involve renovating an existing building or constructing a new one? How large is the project? How expensive is leasing as opposed to buying property in your community?

Even with these variables, it's possible to develop a useful preliminary estimate fairly quickly in the planning process (see [Guidance for Estimating Project Costs](#)). Eventually you'll need to develop a more refined and accurate estimate that reflects the specifics of the program, site, and building needs. Both of these steps are explained below.



# DETERMINING CAPITAL COSTS

## Developing a Capital Budget

Every program has an annual operating budget that reflects ongoing program expenses. This budget includes all income and expenses related to the program, and it spans a specific period of time: the organization's fiscal year. Building a new space or renovating an existing one, however, requires a different financial tool called a **capital budget**, which includes all of the costs associated with the proposed investment in the new or renovated facility. This capital budget is prepared only if and when the organization undertakes a facility project; as such, it's more like a bucket that holds all one-time expenditures associated with purchasing, improving, or building a physical asset—even if it takes several years to complete.

The capital budget—sometimes called a “statement of sources and uses” or a “development budget”—has two parts: **sources**, such as grants and loans; and **uses**, which include all hard and soft costs related to planning and construction (see Hard and Soft Costs in the box below).



### Hard and Soft Costs

Land, buildings, and equipment are called **hard costs** because they are the “hard” physical items you can touch. Professional services, taxes, insurance premiums, and other fees are considered **soft costs** because, while they fund services and fees that are essential to the project, they represent those things that are typically less tangible. Please note that any use of Head Start funds for either hard or soft costs contributes to the federal interest in your facility. A federal interest is the federal government's share in a property, based on the Federal funding that went towards acquiring or upgrading it.



The capital budget for the facility includes the following types of expenses:

- The purchase price of the property if the organization is buying a building and/or land
- Construction and site infrastructure (which might include bringing sewage services and water to the site), utility connections, and landscaping costs, including the cost of materials and labor
- Outlays for indoor and outdoor equipment and furnishings
- The salary or fee for a project manager
- Fees for professional services for project planning and oversight, including architects, engineers, and lawyers
- Filing and application fees, the cost of a site survey and appraisal, property taxes paid while the building is being constructed, and liability insurance—all expenditures that are made before the structure is ready for occupancy.

In budgeting for both hard and soft costs, it's wise to estimate 10 to 15 percent more for each line item to cover unanticipated cost over-runs.

Below is a template for a capital budget. However, if you are applying to Head Start for any facilities funds, check with your federal regional office to determine if they would like you to use another specific budget template for that purpose.



SAMPLE CAPITAL BUDGET <sup>1</sup>	
<b>SITE ACQUISITION</b>	<b>Total</b>
Property Purchase	
<b>Total Site Acquisition</b>	\$ _____
<b>HARD COSTS</b>	
General Contractor	
Demolition	\$ _____
Grading, Excavation and Foundation	\$ _____
Framing and Drywall	\$ _____
Roofing	\$ _____
Sprinkler & Fire Alarm System	\$ _____
Electrical and Lighting	\$ _____
Plumbing and Fixtures	\$ _____
HVAC	\$ _____
Finish Work	\$ _____
Parking and Landscape	\$ _____
Playground Equipment	\$ _____
Telephone/IT System	\$ _____
<b>Total Hard Costs</b>	\$ _____
<b>SOFT COSTS</b>	
Professional Services	
Architect/Engineer	\$ _____
Attorney	\$ _____
Project Manager	\$ _____
Environmental	\$ _____
Building Permits	\$ _____
Site Survey	\$ _____
Appraisal	\$ _____
Liability Insurance	\$ _____
Property Taxes (while building is constructed)	\$ _____
Financing Costs	
Construction Interest	\$ _____
Loan/Financing fees	\$ _____
<b>Total Soft Costs</b>	\$ _____
<b>START-UP COSTS</b>	
Furnishings	\$ _____
Moving Costs	\$ _____
Other	\$ _____
<b>Total Start-Up Costs</b>	\$ _____
<b>TOTAL CAPITAL COSTS</b>	<b>\$ _____</b>

1 Gillman, A., Larson, C., Sussman, C. (2005). *Community Investment Collaborative for Kids Resource Guide* (pg. 51). New York: Local Initiatives Support Corporation/Community Investment Collaborative for Kids



### Funding “Pre-Construction”

When preparing a capital budget for the first time, it’s easy to overlook all of those things that must be done well before ground is officially broken on the project or before the renovation even begins. Organizations typically begin to incur project-related expenses months and even years before construction begins. Architects and lawyers, for example, generally bill for their services as they help you evaluate potential sites, propose changes to existing ones, and negotiate purchase, leasing, or construction agreements. You will also likely need to make a down payment or deposit to bind a purchase or lease agreement, and some construction companies require a percentage payment in advance of beginning their work. These “pre-construction” expenses are commonly 5 to 10 percent of the total project cost. The sample pre-construction budget below lists typical pre-construction items.

SAMPLE PRE-CONSTRUCTION BUDGET	
Professional Services	
Architect/Engineer	\$ _____
Attorney	\$ _____
Project Manager/Development Consultant	\$ _____
Environmental Testing	\$ _____
Building Permits	\$ _____
Site Survey	\$ _____
Site Control (Deposit or Purchase)	\$ _____
Appraisal	\$ _____
Liability Insurance and Taxes (if site is acquired prior to construction)	\$ _____
Financing Application Fees	\$ _____
<b>TOTAL PRE-CONSTRUCTION</b>	<b>\$ _____</b>

Even if you secure early capital commitments, there are many funding sources that you can’t use until construction officially begins because they can only be spent on construction, not planning or other pre-construction or soft costs. In addition, it’s common that capital grants will be committed only after you have proven your ability to raise 100 percent of the necessary financing. Since you will still be involved in finding the funds for the project at this stage, it’s unlikely that all of the necessary dollars will be in place. Yet, you’ll still need access to cash for those preconstruction expenses, so these restrictions can create a



cash-flow problem for projects. If you are a Head Start grantee, it's possible, with pre-approval, to use Head Start grant funds for pre-construction costs. Requirements for using those funds can be found at 45 CFR 1309.43 (at the website <http://eclkc.ohs.acf.hhs.gov/hslc/standards/hspps/1309>).

Some grantee agencies have unrestricted net assets that they can tap; this, of course, creates the fastest and easiest situation for funding preconstruction expenses. While not all agencies will find themselves with such a favorable option, there are other resources available that they can use (more on this below).

However, before you commit your unrestricted assets to these preconstruction costs, you'll need to consider some important questions. First, as a grantee, do you have a sufficient cushion of working capital in case the project takes longer to complete than originally planned? If your plans are delayed, your organization will need also to delay getting reimbursed by project-related funding, thus delaying the replenishment of your cash reserves. In a worst-case scenario, such as the project not moving forward successfully, those cash reserves may never be reimbursed and you would end up having to write off your preconstruction investment as a loss. To mitigate this risk, you should identify other stakeholders and funders who are willing to share the risk of pre-construction expenditures.

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Once you've raised sufficient resources for the project and construction can begin, you may then be able to tap your project-related capital funding sources so your organization can reimburse itself for the initial outlay. However, some capital sources can only be used to cover future expenses and cannot be applied retroactively for previously incurred expenses. Each funding source is different, so grantee agencies will want to check the specific requirements for each source very carefully.

Those organizations that do not have access to the type of ready organizational assets described above should explore the following kinds of alternative funding sources for their preconstruction expenses:

- **Community Development Block Grants** are federal funds available through cities and towns or through the state (for less urbanized communities). These grants can be used to cover pre-construction planning expenses. Find more details on this source below.
- Some **private foundations** offer planning grants, and others may be willing to set aside a portion of a larger capital grant to be used prior to construction to help cover planning costs. Find more details on this source below.



- **Community development lenders** or **community development financial institutions (CDFIs)** are another potential source of preconstruction funding. Sometimes referred to as “community development financial institutions,” “community development intermediaries,” or “community loan funds,” these lenders (often nonprofit organizations but sometimes public agencies) are capitalized to make pre-construction loans that conventional financial institutions consider too risky. Some of these lenders offer a loan-like product that permits the debt to be forgiven if the borrower is forced to abandon a project because it becomes infeasible. Some community development lenders are national, although most serve a metropolitan area, state, or region (see the box below).
- **Deferring fees** is another way to finance pre-construction costs. Members of a project’s development team, such as an architect or lawyer, may agree to defer their fees until you close on your loan for the construction costs.
- Nonprofit organizations can also ask an area lawyer or legal firm that supports the nonprofit’s mission to provide **pro bono services**.



Most community development lenders belong to the **Opportunity Finance Network (OFN)**, a national network of community development financial institutions (CDFIs) that make low-interest loans to benefit underserved communities. Many CDFIs provide financing for Head Start facilities. OFN members can be located by geographic area at <http://ofn.org/cdfi-locator>.

Community development lenders who specialize in providing financing for Head Start and other early childhood facilities have formed the **National Children’s Facilities Network (NCFN)**. A listing of members and the geographic areas they serve can be found at [www.ncfn.org](http://www.ncfn.org).

## Preparing the Capital Budget

The prospect of creating a capital budget may appear daunting at first, especially if the process is new to you. However, with care, planning, and work, you can make the process manageable. Developing a capital budget involves the following five steps:

1. **Start with an initial estimate:** This early projection of costs will give you a sense of approximately how much money you need, and it will help you assess whether it’s feasible to proceed with the project. At this point, a specific site may not have been identified or the specifics around a major renovation may not be exactly defined. It’s important to know that a capital budget frequently and necessarily changes as a grantee learns more about its site or renovation needs and decides how to design and equip the space. As the project moves forward, the budget will more accurately reflect the project’s actual cost. (See [Two Methods for Quickly Estimating the Cost of a Project](#)2 below.)



2. **Revise the budget once you have identified a site or project.** Once you know what you want to do and where you want to do it, you can refine your estimate based on specific information, such as a purchase price or known conditions—the age or type of a building or the extent of renovations to be carried out at an existing location. As the architect prepares preliminary design schemes and engineers look for environmental hazards or structural issues, you will know more about additional costs, such as the expense of removing asbestos or lead. Although still fairly early in the planning process, at this stage the architect might consult a “cost estimator” to approximate the hard construction costs.
3. **Revise the budget when the design development phase draws to a close.** At this point there will be fewer uncertainties. With detailed plans you can produce a more refined capital budget. For example, the construction line of a capital budget will expand to include such detailed expenses as excavation, site preparation, demolition, carpentry, drywall, plumbing, and electrical work.
4. **Expect to revise the budget again after receiving contractor bids.** Labor and material costs change constantly, so the most accurate budget will include the construction contractor’s bid. See the box below on **value engineering** for situations where the contractor’s estimate exceeds available resources.



### **Value Engineering; or What to Do When the Contractor’s Price Exceeds the Financial Commitments You Have Secured.**

After your project goes out to bid you will identify a preferred contractor based on several factors, including bid, reputation, and experience working on similar facilities or equivalent-size projects or with nonprofit organizations. In many cases the preferred contractor’s price, after negotiation, will exceed the funding commitments you have in hand, and you will need to modify your construction plans to bring the cost in line with available resources. This process is called **value engineering** and typically involves substituting less costly material or removing design features that are not essential. If you must reduce the cost of the project, carefully consider the impact on quality or durability that is caused by eliminating certain features or using particular materials. For example, you may have decided to install in-floor radiant heating, which can provide the most comfort for young children who spend considerable time on or close to the floor. Since conventional baseboard heating is far less expensive, you might be forced to make the difficult decision to substitute the one for the other. Another strategy is to postpone expenditures by removing items from the construction budget while you continue to secure resources for additional phases of work. For example, if you have good reason to believe that you can raise additional money for playground equipment, you could eliminate this component from the construction contract and



build out the playground as part of a separate contract at a later date. These types of choices are obviously challenging and potentially risky. A playground is an essential element of an early care and education center, and if you fail to raise the money for the equipment there could be serious negative implications for the program.

It is unusual and not recommended for an organization to go out to bid a second time on a project instead of attempting to negotiate with a preferred contractor who took the time and made the effort to respond to the original bid request. This process is very time consuming; re-bidding is not likely to yield new bidders and may be off-putting to the contractors who initially responded.

5. **Don't forget to budget for unanticipated expenses.** Even after construction begins, unexpected circumstances frequently arise and create additional costs. For example, during excavation the contractor may discover a foundation wall from a building that previously stood on the site. The grantee will need to absorb the unplanned expense of demolishing and disposing of the wall. To prevent such unpleasant surprises from adversely affecting the project, the capital budget should include a **construction cushion** of at least 10 percent of hard costs. When renovating an existing building, this cushion may need to be higher, perhaps 15 percent, since existing structures are more likely than vacant land to conceal costly "surprises" behind their walls.



TWO METHODS FOR QUICKLY ESTIMATING THE COST OF A PROJECT<sup>2</sup>

**HINTS:** State licensing requires only 35 square feet of classroom space per child, but to create quality space you should provide 45 to 55 square feet per child not counting space used by large objects like refrigerators or counters. Even more space is needed for infant and toddler rooms. Double this number to allow for non-classroom space such as multi-purpose space, bathrooms, kitchen, offices, hallways, etc. Remember, you want two estimates, a modest, low-end one and a more ambitious high-end version.

**HINTS:** Child care space tends to be 40-50% more expensive than other commercial space because of more extensive plumbing, child-size fixtures, built-in cabinets and counters and other specialized features. To come up with a cost per square foot, ask some architects or contractors for the “total development costs” (not just the construction cost) per square foot for commercial space in your area and multiply that by 1.5. Once again, look for a range. Use the lowest number and the highest.

**EXAMPLE A:**

To estimate the approximate cost for a major new construction or renovation project you need three figures:

	LOW	HIGH
1. Gross square feet per child	70	110
2. Number of children the facility will be licensed to serve	100	100
3. Cost per square foot	125	300
<b>ESTIMATED COST</b>	<b>\$875,000</b>	<b>\$3,300,000</b>

**HINT:** Multiply the three numbers in each column. For example, in the “low” column, multiple  $70 \times 100 \times 125 = \$875,000$ .

**HINT:** You could say that your project will cost between \$900,000 and \$3 million or pick a figure between the two but on the high side, perhaps about \$2 million.

**EXAMPLE B:**

To estimate the approximate cost for a small-scale renovation or improvement project:

1. Collect contractor estimates	\$35,000	\$65,000	\$80,000
2. Average all but the lowest estimate	\$35,000	\$72,500	
3. Build in a cushion		25%	
<b>ESTIMATED COST</b>		<b>\$90,625</b>	

**HINT:** Average the remaining estimates.

**HINT:** Multiply the average estimate by 1.25 (that will increase the average by 25%). The result is your estimated project cost.

**HINT:** Eliminate the lowest estimate.

2 Gillman, A., Larson, C., Sussman, C. (2005). *Community Investment Collaborative for Kids Resource Guide* (pg. 42). New York: Local Initiatives Support Corporation/Community Investment Collaborative for Kids.



## FINDING SOURCES OF FUNDING

There is no typical financing strategy for an early care and education facility. Each project relies on its unique set of organizational strengths, opportunities, and relationships, as well as on site-specific funding possibilities. Often a program will need to be creative in the way it assembles funds from a variety of sources—including public and private (corporations, individuals, and foundations) and in the form of grants and loans—before it can proceed with a facility improvement project. But remember, if you are using any Head Start funds, make sure you comply with Head Start regulations found in 45 CFR 1309. Among other things, these regulations govern the way you use funds to pay off any mortgage principal or interest. You'll also want to remember the specific regulations that govern Head Start facilities and that these regulations characterize any debt service payments as an ongoing purchase.



**Debt service** consists of the amount of money in both principal and interest that you pay on a loan over a period of time. A debt service is typically calculated for a year. For example, if your center borrows \$100,000 at 9 percent interest for 10 years, the principal and interest—that is, the debt service—for the first year is \$6,333.79.

Potential funding sources fall into three major categories:

- Financial assets
- Loans
- Grants and gifts



### Financial Assets

Two sources of financial assets may already be available to programs looking to relocate or renovate: real estate assets and savings and investments.

### Real Estate Assets

If a program is vacating a building it owns, selling the existing location can generate financial resources that may be used to help cover the cost of a new facility. If there is a federal interest in the building being sold—for example, if it was purchased with the help of Head Start funds—the funding organization (Head Start, in this example) will need to grant its approval to the sale. Also, whatever federal dollars were invested in that original property will have to be accounted for and included in the calculation of federal interest when the property is sold. More information on relevant regulations can be found at <http://eclkc.ohs.acf.hhs.gov/hslc/standards/hspss/1309>.

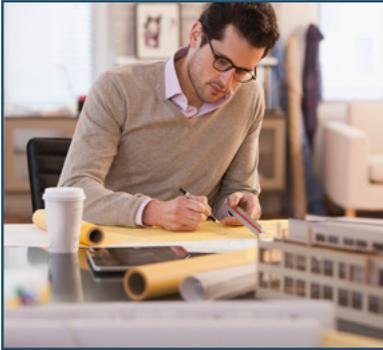


### Savings or Investments

Some grantees have access to unrestricted financial assets that they can use to cover the capital costs of a new or improved facility. An accountant can help you determine whether it is advisable to tap your organization's accumulated savings or investments for this purpose. A new or newly renovated facility can be a valuable organizational asset, and therefore a smart, long-term investment, as long as it does not leave the organization short of working capital or without a comfortable cushion to address any unforeseen financial needs that may arise.

### Loans

Debt is a necessary component of most plans for financing a major capital investment. A loan—and the burden of the accompanying debt—fills the gap between the total cost of the project and the grants and donations that can be raised. Taking out a loan and thus accruing some debt enables an organization to spread capital costs over many years. **But remember, this is a commitment that your governing body needs to make, fully understanding the repercussions of incurring debt.** By requiring the payment of only a portion of the cost each year rather than the entire amount up front, loans make capital expenditures more affordable. However, spreading the cost over multiple years only works if there is income available to pay the monthly principal and interest payments over those years. In other words, grantees should never borrow more than their income can support. If you are a Head Start grantee, **the fiscal expert on your governing body can guide the organization's leadership on whether this is a good idea or not.**



Pursuing debt financing for a facility project can be complicated for organizations that do not have prior borrowing experience. In fact, if members of an organization lack prior real estate development experience, they should consider retaining the services of a development consultant to help them select the site and the architect and secure necessary permits, as well as to help them with the financing. Grantees with a seasoned chief financial officer will want to include him or her in any bank negotiations, and others should involve a board member who understands commercial financing.



Some projects, even large ones, can be straightforward. Others can be complicated and time consuming. For that second type, we don't recommend relying on pro bono contractors or development consultants; you simply can't count on them to make your project a priority.

## Sources of Loans

### Conventional Banks

Banks are the most obvious source of loans. When looking for a loan, organizations will want to know about the following:

- **Commercial vs. residential loans:** A bank will treat a loan for an early care and education center as a commercial loan. There are no set terms for commercial loans, although they are usually written with much shorter terms than the 30-year fixed-rate loan that is the standard for residential mortgage lending.
- **Balloon loans:** A borrower may repay a loan in full over the term of the loan. For example, a 10-year loan would be fully repaid in 10 years. However, some lenders may offer a repayment schedule for a 10-year loan that is based on a longer amortization period—perhaps 15, 20, or 30 years; this makes the monthly principal and interest payments much less—and typically more affordable—to the borrower. However, the balance of the entire loan, the lump sum that has not yet been paid off, is still due at the end of the 10 years. This type of loan is commonly referred to as a “balloon” loan because of the relatively large size of the outstanding balance that comes due at the end of the original term (10 years in our example). Most lenders generally assume that the outstanding balance (the “balloon”) will be refinanced at the end of the term, since it is not often financially feasible for most borrowers to make such a large payment at that time.

If you have a balloon loan, plan to refinance several months before the final balloon payment comes due. If you're unable to refinance the loan because of changed circumstances or if the balloon payment sneaks up on you, talk to your lender about refinancing options that will help you pay off the balloon mortgage and replace it with a new loan. Most lenders will be happy to work with you to avoid foreclosure or the need to sell the property.



It's also important to remember that, if you are using Head Start funds for any of the debt service, you need to seek guidance from your Regional Office prior to agreeing to the terms of a balloon loan. The Head Start Regional Office will want to ensure that Head Start funds are protected in the arrangement.

Balloon loans come with additional cautions: Most balloon loan customers proceed with the assumption that they will be able to refinance their loan at the end of the loan term at the rate of interest that prevailed at the time they first borrowed, especially if they promptly made each month's loan payment when due. However, refinancing isn't always a viable option in a declining real estate market and interest rates may have increased since the original loan. So unless there is a compelling need or justification for a balloon loan that requires refinancing, you're better off accepting a loan with the stable or fixed terms and amortization schedule.



If you are using Head Start funds for any of the debt service, you need to seek guidance from your Regional Office prior to agreeing to the terms of a balloon loan. The Head Start Regional Office will want to ensure that Head Start funds are protected in the arrangement.

If you take out a balloon loan, don't assume that you will be able to refinance your loan at the rate of interest that prevailed at the time you first borrowed. Also, refinancing isn't always a viable option in a declining real estate market. So unless there is a compelling need or justification for a balloon loan that requires refinancing, you're better off accepting loans with the same terms and amortization schedule.

- » **Refinancing:** For Head Start grantees, if conditions are conducive for refinancing an existing loan (e.g., interest rates drop significantly lower than your existing loan), you'll need to seek approval from the Office of Head Start and comply with Head Start facilities regulations outlined in the Head Start Program Performance Standards (HSPPS) 45 CFR 1309. The Head Start Regional Office will require the grantee to present a cost comparison demonstrating that the new financing terms are reasonable; regional staff will also examine the effect of the refinancing on the status of the recorded federal interest, among other factors. For more details on refinancing loans using Head Start resources, go to [http://eclkc.ohs.acf.hhs.gov/hslc/standards/pi/2009/resour\\_pri\\_010\\_120809.html](http://eclkc.ohs.acf.hhs.gov/hslc/standards/pi/2009/resour_pri_010_120809.html).



- » **Community Reinvestment Act (CRA):** The Community Reinvestment Act is a federal law enacted in 1977 designed to encourage banks to help meet the needs of borrowers who operate in lower-income communities. This act was passed to overcome shortages of available credit in poor neighborhoods. While some economists and experts in the financial industry have questioned the effectiveness of CRA, others believe that it has served as a catalyst to induce banks to better serve lower-income markets. Studies have shown increased lending in low-income communities since the act's passage. While CRA may open the door to banks that might previously have rejected a loan request, getting a loan approved still requires you to meet the same underwriting standards that the banks apply to all other loan applicants.



**Mitigating lender risk:** Before committing to a real estate loan, a bank needs to satisfy itself that borrowers will have sufficient monthly revenue to meet their operating expenses on time, including the payment of principal and interest on the loan. Moreover, since there is always the risk that a borrower will encounter unanticipated financial difficulties, the bank also will require security or collateral to give them a fallback position—something the bank can sell to recover the money it lent if the borrower isn't able to keep up with payments. That fallback is usually the real estate asset it is lending against, although sometimes a bank will accept other assets, such as a lien on another property owned by the grantee or a financial asset if the borrower is fortunate enough to have an endowment. A lender will also require an appraisal to establish that the market value of the real estate is sufficient to satisfy the debt in the event of foreclosure. If, after securing collateral and a sound appraisal, a bank still believes that the risk is excessive, it may seek additional collateral in the form of a third-party loan guarantee, such as those available from the U.S. Department of Agriculture Rural Development Community Facilities Program discussed below. Government agencies are the most common source of loan guarantees. See below for more information on collateral, appraisals, and guarantees.

### Less Conventional Sources of Loans

Since many bankers are unfamiliar with non-profit early care and education programs, like Head Start, they may be cautious about the perceived risk in making a loan to this type of program. If that is the case, you'll want to start with your current banker, who will want to keep your business and will likely better understand your operations. Other less risk-averse sources of debt for early care and education facility projects include government programs and nonprofit community development lenders, described below.



### Government Lenders

- **U.S. Department of Agriculture Rural Development Community Facilities Program.** For rural and exurban areas with populations smaller than 20,000, the U.S. Department of Agriculture Rural Development Community Facilities Program makes very favorable low-cost, long-term loans and loan guarantees for the renovation and construction of community facilities, such as Head Start centers. For more information, go to <http://www.rd.usda.gov/programs-services/community-facilities-direct-loan-grant-program>.
- **State Loan Programs.** Some states sponsor loan programs that can be tapped by early care and education organizations. In addition to direct loans, some states provide partial loan guarantees to a private lender and/or interest rate subsidies to reduce the cost of borrowing, thereby increasing the amount a nonprofit might be eligible to borrow from a private lender. The publication *Building Early Childhood Facilities: What States Can Do to Create Supply and Promote Quality* describes state facility financing programs and is available at <http://www.lisc.org/content/publications/detail/5940/>.
- **State Tax-Exempt Bond Financing.** The federal tax code provides a tax exemption on the interest earned on qualifying loans to nonprofit organizations. These are called “tax-exempt bonds.” Each state has a quasi-public agency that administers the tax-exempt bond program. The benefit of this kind of financing is that the tax exemption should translate into a lower interest rate for the borrower. These bonds may also provide a longer repayment or amortization schedule than a conventional bank loan. However, the transaction costs are high because of the legal restrictions involved. Therefore, tax-exempt bond financing generally only makes sense for large loans—those for at least \$1 to \$2 million. Your state economic development department can identify the agency in your state that serves as an issuer of tax-exempt bonds. That agency should be able to help determine if the savings promised from the lower tax-exempt interest rates will be sufficient to offset the higher transaction costs associated with issuing the bonds. You’ll find additional helpful information on tax-exempt bonds at <https://www.orrick.com/Events-and-Publications/Documents/172.pdf>.
- **Tax Increment Financing (TIF):** Another economic development tool available in certain states and jurisdictions is tax increment financing. Since investments in distressed areas have a positive impact on the value of surrounding properties, those investments can be expected to increase property tax revenues over the long term. Tax increment financing is a mechanism that county and local governments use to divert a portion of their increasing property tax revenue to cover the costs of loans or municipal bonds that could be used for facilities improvements. These loans can be used to reduce some of the costs associated with building an early care and education center. To find out more about whether TIFs are available in your state and can be used for early care and education facilities, contact your state’s department of economic development.





### Community Development Lenders

Many areas of the country are now served by nonprofit community lenders that manage tax-exempt bonds similar to those described above. The nonprofit community lenders that make these funds available can be national, regional, or local. Many support a range of neighborhood-based real estate projects, including housing or retail space, while others specialize in community facilities such as Head Start or child care facilities. These lenders can be a valuable source of technical assistance as well as loans. The following list offers a few examples of community development lenders:

- The Local Initiatives Support Corporation (LISC) is a national nonprofit community development lender that provides financing and technical assistance for a broad range of neighborhood revitalization projects, including community facilities such as Head Start and child care, across 31 cities and in many rural areas (<http://www.lisc.org/>).
- IFF, a regional community development lender, provides loans and technical support for community facility projects including Head Start centers in [Illinois](#), [Indiana](#), [Iowa](#), [Missouri](#), and [Wisconsin](#) (<http://www.iff.org/about-iff>).
- The Center for Community Self-Help is a statewide nonprofit that offers financing and technical assistance to a broad range of businesses and service providers, including Head Start centers throughout the state of North Carolina (<https://www.self-help.org/>).

These and other community development lenders can be found through the Opportunity Finance Network (<http://www.opportunityfinance.net>) and the National Children's Facilities Network ([www.ncfn.org](http://www.ncfn.org)).

### Shopping for a Loan

When shopping for the most appropriate and affordable loan, a borrower should evaluate a number of factors:

- Interest rate
- Term or repayment period—the number of years over which the loan is repaid
- Principal—the amount a lender will provide
- Closing costs, including the application fee, the lender's legal fees, and appraisal charges



As you consider a loan for a facility project, you'll want to identify the lowest interest rate and lender fees possible and be careful not to borrow more than you need or for a longer term than is necessary. At the same time, you should understand that the longer the loan term, the smaller the monthly or quarterly payments that are due. You should also look for a loan that allows you to prepay without a penalty fee in the event that you can pay off the loan sooner than you originally anticipated. Also, be aware that if your



organization receives an Office of Management and Budget (OMB) annual audit, a bank may be willing to give you a better interest rate because audits demonstrate an organization's accountability and promote long-term confidence in your program's commitment to fiscal integrity.



### When Considering a Loan for a Facility Project

- Identify the lowest interest rate and lender fees possible.
- Be careful not to borrow more than you need or for a longer term than is necessary.
- Understand that the longer the loan term, the smaller the monthly or quarterly payments that are due.
- Look for a loan that allows you to prepay without a penalty fee in the event that you can pay off the loan sooner than you originally anticipated.

Online you will find many free loan payment calculators that will help you compare the monthly cost of a loan with different interest rates and repayment periods. One such calculator is at <http://www.mortgagecalculator.org/>

### Lender Requirements

Lenders have two main concerns:

1. Does the borrower have the ability to repay?
2. If the borrower is unable to repay the loan, how can the lender recover its money?

When you apply for a real estate loan, the lender will want a significant amount of information about your organization, its finances, and the property that will be purchased, constructed, or improved. The lender will evaluate the property's value as **collateral** to support the loan (see "[Collateral](#)" below).

The lender will also want to review the following:

- A description of the organization's senior staff and officers to determine the organization's qualifications and reputation
- Audited financial statements, tax returns, and bank records for the previous three years
- Credit history to see whether prior loans have been paid on time
- Corporate bylaws and incorporation documents



- Future financial projections showing
  - » an estimate of how the business is expected to perform in the new facility and
  - » an ability to repay the loan over time
- Copies of relevant contracts, including the agreement under which Head Start and other relevant programs or services are being provided in the facility

In the case of a Head Start agency, while the loan proceeds will be used for the grantee's facility, the loan, related promissory note, mortgage, and any security agreements are legal agreements with the Head Start grantee and not the Office of Head Start. Funders need to know that the Head Start grantee is part of an overall operation that is fiscally strong. Therefore grantees should expect



lenders and certain other funders to request financial, governance, and operating information for the overall organization as well as a specific budget breakdown for the Head Start program.

All of this documentation will enable the lender to assess your organization's ability to be reliable in making monthly debt service payments while you also meet your operating costs.

In addition, when purchasing real estate or using it as collateral for a loan, the bank will typically order the following:

- An appraisal to determine the value of the property
- A title search, title report, or abstract of title to make sure that no one else has a legal right to the property and that the seller is the legal owner

In some situations, banks may require a survey of the property as well. Since these services are required by the bank but provided to the borrower by third parties, the borrower will be responsible for their cost.

### Collateral

If a borrower is unable to repay a loan, the lender will want to have another way to recover its money. This is often done through real estate collateral: a mortgage on the property or on another piece of real estate owned by the organization. (But be aware that a Head Start grantee must receive permission from the Office of Head Start to make any pledges of property that have a federal interest; see below.) If the borrower fails to repay, the mortgage gives the lender the legal right to foreclose on the property in order to recover the money owed.



If Head Start funds are used for a project, the grantee will be required to comply with the requirements of 45 CFR Part 1309 by including special mortgage language required in 45 CFR 1309.22 and recording a notice of federal interest, in compliance with 45 CFR 1309.21. Lenders may request that Head Start subordinate the federal government's interest in the property to the bank's loan. Subordination allows the bank to have priority over the federal share in the facility for its claim in the event of a foreclosure of the mortgage. Subordination agreements are entered into at the discretion of the Administration for Children and Families and the lender; grantees alone can't subordinate the federal interest in the loan.

### Appraisals

Lenders will use a professional appraiser to determine the market value of any property that is being used as collateral to back up a loan. To further reduce the risk of not being fully repaid, commercial lenders will typically lend only up to 80 percent of the value of the property as determined by the appraisal. Community development lenders will sometimes accept more risk than private banks, and they may provide a loan that is closer to 100 percent of the property's value.

### Guarantees

If you need a loan but lenders are unwilling to give you one because of the perceived risk of default, you can overcome a lender's concerns by securing a loan guarantee. Essentially, the organization that guarantees the loan—the guarantor—enters into an agreement with your bank and creates a binding legal agreement that obligates them (the guarantor) to repay some or all of the outstanding loan principal if the bank ends up foreclosing on the loan. With this guarantee, lenders may give you a loan they would otherwise deny. The guarantee makes them confident that they will be repaid.

Government agencies are the most common source of loan guarantees; and some states (such as Arkansas, Connecticut, and Maryland) have guarantee programs tailored specifically to early childhood initiatives, including Head Start. Loan guarantees are usually administered through a state's economic development agency or one of its quasi-public financing agencies; these agencies can determine whether your project might qualify. Grantees in rural areas may qualify for U.S. Department of Agriculture Rural Development Community Facilities resources, which could also be potential sources for a loan guarantee, in addition to any resources their state might provide.

### Personal security

A bank may ask directors of nonprofit organizations to provide personal security, such as a mortgage on their homes. However, pledges of personal security violate a strict prohibition against conflicts of interest and are an unreasonable request of volunteer directors.



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## Grants and Gifts

For many non-profits, grants and gifts can be a significant source of capital funding. Sources of grants and gifts fall into four categories: (1) public sector, (2) foundation, (3) corporate, and (4) individual.

### Public Sector

Every level of government is a potential source of grants. These grants can be critical sources of funding for early care and education programs.

Grantees should keep in mind that most federal sources require compliance with the Davis Bacon Act, which requires that prevailing wage rates be paid to laborers and mechanics; usually these rates are somewhat higher than the rates that general contractors might otherwise use in their bids. Many states also have similar prevailing wage laws when using grant money from the state. For more information, go to <http://wdol.gov/dba.aspx>.

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Below are some common sources of capital grants that can be tapped by early care and education organizations:

- **U.S. Department of Health and Human Services, Administration for Children and Families (ACF).** The Office of Head Start, managed by the Administration for Children and Families, makes facilities grants available to Head Start grantees. Head Start grantees should contact their regional office of ACF to explore these funding opportunities. Online resources available at the following URL answer questions about how to comply with regulations related to the acquisition, renovation, or construction of a facility using federal Head Start funds: [http://eclkc.ohs.acf.hhs.gov/hslc/standards/PIs/2009/resour\\_pri\\_010\\_120809.html](http://eclkc.ohs.acf.hhs.gov/hslc/standards/PIs/2009/resour_pri_010_120809.html)



- **Community Development Block Grants (CDBG).** The federal government provides CDBG funds to cities and towns. In cities with more than 50,000 people and counties with more than 200,000 people, the local government distributes the funds. In more rural areas, the state administers the CDBG program. CDBG grants support a range of community revitalization projects, including Head Start and child care centers. Projects must primarily benefit low- and moderate-income people. CDBG can cover the cost of renovation or construction, as well as such preconstruction planning expenses as architectural and engineering fees. For more information, go to [http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/comm\\_planning/communitydevelopment/programs](http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/communitydevelopment/programs).
- **U.S. Department of Agriculture, Rural Development Community Facilities.** For communities with fewer than 20,000 people, USDA Rural Development's community facilities program offers small grants for early care and education facilities projects, in addition to loans and loan guarantees (see [Loans](#) above). For more information, go to <http://www.rd.usda.gov/programs-services/community-facilities-direct-loan-grant-program>.
- **Public Land Disposition:** Many local governments foreclose on properties when taxes aren't paid or they have been abandoned. They also may own municipal facilities, such as a former police station or a school, that have been replaced and are no longer used. Such properties can sometimes be acquired at little or no cost or leased at a favorable rate under a long-term lease arrangement. However, organizations should be aware that these properties may require substantial upgrades, environmental remediation, or retrofitting to be appropriate for early care and education use.
- **Special Purpose Funding:** Individual jurisdictions may have special purpose funding opportunities, depending on local resources and policy priorities. For example, grants may be available to help pay for community facilities at transit hubs or to encourage the use of environmentally friendly "green building" technologies. In some cases, a city councilmember, state legislator, congressperson, or senator can secure one-time funds for a specific project, although this type of "earmark" is increasingly scarce. Some states or cities also issue bonds to fund capital improvement projects in local districts or for special purposes, such as various types of community facilities. Active support from your elected representative is important—and often essential—to securing these kinds of capital improvement grants.



### Finding public-sector financing

To identify sources for public-sector financing in a specific geographic region, you'll want to begin by consulting your elected representatives as well as state or city officials. Enlist the support of these officials as you would a foundation executive or individual donor and provide them with information about your program and its benefits to the people in the community. An invitation to tour your current early care and



education facility can be a powerful first step toward securing their support. After site visits are scheduled, consider recruiting parents to welcome officials. Once they've become aware of the value of your efforts, these officials are well positioned to helping you secure public sector grants.

### Accessing federal sources through a community development partner

Some early care and education programs are housed within multiservice agencies engaged in implementing economic development programs in communities. These programs can include affordable housing development, microbusiness finance, and job creation. These multiservice agencies are frequently referred to as **community development corporations (CDC)**, and their activities may qualify them to be certified as Community Housing Development Organizations (CHDOs) and thus eligible to receive certain U.S. Department of Housing and Urban Development (HUD) resources. Their activities also may qualify them to be certified as Community Development Finance Institutions (CDFIs) that compete for funds from the U.S. Department of the Treasury, as described below. Other organizations can access some of these federal resources by partnering with qualifying community development organizations in their communities.

- **U.S. Department of Health and Human Services, Office of Community Services (OCS).** Through its Community Economic Development program, OCS makes grants available for projects that create employment opportunities for low-income people in economically distressed areas. These grants, which are limited to nonprofit CDCs, can include both preconstruction planning grants and capital grants for construction and renovation. The funds are made available through a competitive process, and job creation is a major goal. Those proposals that ensure the creation of the most jobs are the ones most likely to be awarded a grant. To qualify, an early care and education organization might need to be part of a larger project that generates a significant number of jobs. An early care and education program may be able to form a partnership with a CDC that owns property and chooses to develop it for community early care and education use and then lease the space to the early care and education organization. For more information, go to <http://www.acf.hhs.gov/programs/ocs/programs/ced>
- 
- **Federal Tax Credits.** The Federal Internal Revenue Code has provisions to encourage certain types of economic activities by providing a tax shelter for corporations willing to invest in those activities. Nonprofit organizations can create legal entities through which these corporate funds can flow into a facility project, such as an early care and education center. In return for their investment, the corporate investors earn a financial return in the form of savings on their corporate taxes. The investor is, in effect, “a silent partner.” However, please note that if using any Head Start funds to purchase the facility,



these arrangements need to be approved by the Office of Head Start. Head Start grantees will want to consult with their Head Start Regional Office about using federal tax credits before planning for this type of financing. The tax code provides for three types of tax credits: Historic, Low-Income Housing, and New Markets:



If using any Head Start funds to purchase a facility, make sure to involve your Head Start Regional Office early in the process, as staff there will assist you in interpreting how Head Start regulations can be met while using tax credits.

- **Historic Tax Credits.** If an early care and education organization is improving an existing structure that is historically significant and plans to restore historically significant features, the project may qualify for federal historic tax credits. For more information on the federal credits, go to <http://www.nps.gov/tps/>. Many states have Historic Tax Credits as well.
- **Low-Income Housing Tax Credits.** If an early care and education center is being developed in conjunction with an affordable rental housing project, equity sold to corporations using the Low Income Housing Tax Credit (LIHTC) program can be used to subsidize the capital cost of the center. Housing developers apply for these credits at the state level, and the development can include an early care and education facility as part of the proposed housing development. For information on the LIHTC, go to <http://www.enterprisecommunity.com/financing-and-development/low-income-housing-tax-credits/how-low-income-housing-tax-credits-work>.
- **New Markets Tax Credit.** This newer and frequently used federal tax credit for Head Start facilities, the New Markets Tax Credit (NMTC), is designed to promote economic development and/or create jobs in low-income communities. The NMTC creates an incentive in the form of a tax credit to induce banks, businesses, or individuals to invest in certain financial intermediaries called “community development entities,” which in turn invest in projects in targeted economically distressed areas, thus increasing the amount of investment capital available to business and economic development programs in these areas. The NMTC program permits the private-sector investors to receive credits against federal income taxes in exchange for making their investments. The credit provided to the investor totals 39 percent of the amount of the investment and is claimed over a seven-year period. Head Start grantees have successfully tapped this





resource to generate equity for their facility projects. For more information about NMTC see: <https://www.hudexchange.info/resource/436/new-markets-tax-credit-program-summary/>. This program is administered by the U.S. Department of the Treasury, which has a database of organizations that have received credit allocations: [http://www.cdfifund.gov/docs/nmtc/2015/NMTCQEI\\_Report\\_062015.pdf](http://www.cdfifund.gov/docs/nmtc/2015/NMTCQEI_Report_062015.pdf).

If the challenge of the NMTC intrigues you and you think you may have interested and qualified investors—such as real estate developers, banks, or private individuals or businesses—the NMTC is worth exploring. Many nonprofit organizations have benefited from the NMTC—with children and families being the ultimate beneficiaries. The process is complicated. But it is not impossible.

### Resources for the New Markets Tax Credit Program

- » The Internal Revenue Service's publication explaining the New Markets Tax Credit can be found at <http://www.irs.gov/pub/irs-utl/atgnmtc.pdf>
- » Answers to some of the most frequently asked questions about the NMTC can be found at <http://www.communityfundinggroup.org/faqs.html>
- » Success stories from communities that have used NMTC can be found at <http://nmtccoalition.org/>
- » A community in the Portland, Oregon, area that was able to benefit from the NMTC makes its NMTC training PowerPoint available online at <http://www.beavertonoregon.gov/DocumentCenter/View/4803>

Any kind of tax credit financing involves transactions with investors and a complex legal structure. Organizations that want to use this financing will generally need experienced real estate and legal professionals to help them explore whether or not it's possible to use any of the three vehicles described above. If you are a Head Start grantee, you may need to translate Head Start facilities regulations (found in 45 CFR 1309) to these professionals to ensure that they are aware of the restrictions that exist for using Head Start funds in such transactions. It is imperative that Head Start grantees engage their regional office in discussions if they decide they'd like to pursue these financing strategies. If tax credit financing proves practical, grantees will also need expert help in seeking the allocation of credits for the project and in dealing with the highly technical legal steps that must be taken to complete the investment. Grantees with limited resources will want to explore the possibility of pro bono legal assistance; however this option should be pursued carefully. Grantees will want to be sure to identify a firm that is experienced with the specific type of transaction in question and that is large enough to have a formal pro bono program that can dedicate an attorney who will prioritize the project. Most states have pro bono services. To find such services, see <http://www.statebarassociations.org/pb.htm>.

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Organizations will generally need experienced real estate and legal professionals to help them explore whether or not it's possible for them to use federal tax credits.

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### Choreographing Facilities Funding

Christopher House began in 1906 as a community center for Chicago's many immigrants. During its 100-plus years of providing services, the organization has evolved to offer comprehensive education programs—including Head Start and Early Head Start—to at-risk families and children from birth to age 18.

Now in its second century, Christopher House needs to move. As recently as 20 years ago, the organization's headquarters and family resource center in Lincoln Park served the people who lived in the immediate community. But the area's demographics have changed dramatically, and those most in need of services have relocated to other communities. After a comprehensive needs assessment of three Chicago communities was completed in 2007, Christopher House decided to relocate to the high-need, low-income community of Belmont Cragin on Chicago's west side, the community with the greatest need for high-quality early childhood programs. After a long, five-year search for property in the densely populated community, they leased property from the City of Chicago Public Schools with a plan to move its headquarters and family resource center there (including Early Head Start and Head Start services) and expand services to include a new K–8 charter school.

It then took Christopher House all of three years to secure the financing for its new center. They worked in partnership with their Head Start Regional Office throughout the process. Part of the necessary funding came from a \$1.3 million Early Head Start grant; another part through a traditional loan from a major bank; a third from a capital campaign; and a fourth and significant portion came through the New Markets Tax Credit program, which helped to secure \$2.4 million out of the \$16 million the organization raised for the new 47,440-square-foot facility. The process of securing necessary capital is rarely simple; but, according to staff from Christopher House, coordinating all the funding with all the private, governmental and public entities was without a doubt the most complicated, complex and time-consuming component of their fund-raising efforts. Despite the challenges, they said it was well worth the effort as the building now provides early childhood development services to 154 children from 6 weeks to 5 years old and a Kindergarten through 5th grade charter elementary school as well as adult programming in their parent school.

Christopher House became aware of NMTC through one of its board members who happened to be a real estate developer and an attorney. He, along with another board member, also an attorney



Source: Christopher House. Used by permission.



who was knowledgeable about building regulations, provided the pro bono legal help Christopher House needed to secure the NMTC. Another advantage for Christopher House involved the positive working relationship that it had developed over the years with the staff at its bank; these individuals were well aware of Christopher House's stable financial history, and they were interested in maintaining the relationship. Finally, that same bank had a department dedicated to NMTC and so had staff knowledgeable about a very complex process.

Ultimately, five sets of attorneys were involved in securing the funding for the Christopher House real estate development venture. They represented the property owner (Chicago Public Schools), Office of Head Start, Christopher House, the bank, and representatives for the New Market Tax Credits. Staff from Christopher House facilitated communication among all of these entities, a task that was critical to ensuring that all parties were satisfied with both the process and the results. The amount of coordination required was beyond anyone's expectations, but Christopher House staff is pleased: their efforts paid off, since every single one of the funding sources they secured was essential to turning their dream of a family resource center into reality.

### Foundations

Charitable foundations are at the center of nearly every capital campaign. More than 60,000 foundations in the United States offer more than \$30 billion in grants in any typical year.<sup>3</sup> In addition to large national foundations, many more regional, local, community, and family foundations may be interested in supporting your early care and education facility project.

While many foundations have formal policies not to make capital grants, some will make exceptions—particularly if a foundation or one or more of its board members has a pre-existing strategic relationship with your organization. Other foundations may grant exceptions if they make a priority of projects that serve low-income families.

While some foundations rely entirely on a formal application process, it's always helpful to have a relationship with the foundation prior to any application. See below under [Tips for Identifying Foundation Prospects](#) for guidance on finding resources from a variety of private foundations.

- **National Foundations:** A few national foundations provide capital funding for neighborhood-based facility projects. They are more likely to support a building project if it is in their headquarter city or geographic target area or if the project ties directly to the foundation's special interests. Here are a few examples:

<sup>3</sup> Braverman, M. T., Constantine, N. A., & Slater, J. K. (2004). *Foundations and evaluations: Contexts for effective philanthropy* (p. 167). San Francisco: Jossey-Bass.



» **The Kresge Foundation** has a “challenge grant” program (<http://www.kresge.org/sites/default/files/GuidetoChallengeGrant.pdf>) designed to help nonprofit organizations advance their capital campaigns and meet their fundraising goals for new facility construction or renovation. Currently the foundation’s challenge grants for educational facilities are awarded only for renovation projects that formally seek LEED (Leadership in Energy and Environmental Design) certification for high levels of environmental sustainability from the U.S. Green Building Council. See <http://www.usgbc.org/> for more information.



» **KaBOOM!** ([http://kaboom.org/about\\_kaboom](http://kaboom.org/about_kaboom)) is a national organization that helps communities create playgrounds. Through corporate sponsors, KaBOOM! provides playground equipment and volunteer workers. Community partners such as child care programs and Head Start grantees need to provide land for the playground, be able to recruit volunteers to participate in the planning and the playground “build” day, and raise matching funds for the equipment. While not a direct grant-making foundation, KaBOOM! is able to administer challenge grant programs with its funding partners.

- **Community Foundations.** Community foundations pool funds from multiple donors and typically focus their giving on a specific geographic area. Foundation staff may also help direct grantseekers to other potential funding sources or alert one of its donors to the opportunity to support a facility project.
- **Family Foundations:** Wealthy individuals and families often establish private foundations that are typically controlled by family members who sit on the foundation’s board of directors. Family foundations will often respond favorably to requests to support community projects. While some of these foundations have professional staff and operate in the same way as larger foundations, others have a more informal process of considering grant requests. Since many of these foundations are small and may have a low public profile, careful research through a regional association of grantmakers or online database can be very helpful in finding those that are worth pursuing (see suggestions below).

### Tips for Identifying Foundation Prospects

- As organizations consider different foundations, they should check individual guidelines to determine the best way to assess a foundation’s possible interest in their project and the type of approach that will be most successful. Many foundations discourage unsolicited proposals, so organization’s may need first to talk or meet with foundation staff and familiarize them with the project before submitting a request. Information about grant guidelines can generally be found on foundation websites as well as through online databases.
- The Foundation Center ([www.fdncenter.org](http://www.fdncenter.org)) is a good source of information on all types of foundations and features a searchable database of funders who provide capital grants, serve a specific geographic



area, or have an interest in early childhood programs or family support programs such as Head Start. A good source of family foundations in particular can be found at <http://foundationcenter.org/getstarted/topical/family.html>.

- Another strategy for identifying sources of foundation funding is to review the list of donors to other capital campaigns in your locale.
- Most areas of the country are served by regional associations of grantmakers. Grantees can check [www.givingforum.org/ralocator.html](http://www.givingforum.org/ralocator.html) for their local association.
- Grantees should survey the list of trustees of potential foundation prospects and determine if anyone associated with their organization, including board members, knows a trustee. These relationships can provide an entry point and perhaps uncover a valuable ally.



### Helpful Hints for Financing:

- You must be intrepid. Invariably, there will be roadblocks and challenges. Pursuing the advantage of more adventurous or aggressive forms of financing for a building project is not for the faint of heart.
- You have to be well organized.
- It helps to have a good relationship with your bank.
- You have to be good at paperwork. There are many different and exacting reporting requirements, and any single source of financing will probably be only one of many sources of revenue for your project, each of which will invariably have its own set of complicated reporting standards.
- You have to like to talk with attorneys, bankers, accountants and your funders.
- It helps to enjoy puzzles. Financing and fund-raising are not dot-to-dot processes. In fact, there are large legal firms with lawyers whose sole job is to interpret and understand the laws governing real estate financing. As well, there are many organizations founded solely on their ability to help not-for-profits raise money. Know in advance that you are embarking on an adventure—and that you may never completely understand the intricacies of the process.



- It helps to have connections, especially among lawyers and accountants. Look to your board members and to their friends or to firms that share your commitment to improving communities. Your chances of taking advantage of the more sophisticated forms of financing will improve exponentially if you can secure pro bono help from experienced legal counsel and accounting firms. And don't be afraid to ask for help.
- You must be willing—and eager—to stay in regular contact with the key players. You may need a local lawyer who has experience with the real estate financing, and if you are a Head Start grantee, you will need to work with members of your Head Start Regional Office staff, who will obtain approval from the Head Start lawyers. Both sets of counsel need to be kept apprised of your progress and be in agreement on the nature and direction of your activities.

## Corporations

### Small grants

Some businesses will make modest grants as a way of gaining good will in the local community. Regulated companies, such as banks and utilities, can be especially eager to enhance their reputation in this way; and large retail chain stores and other similar businesses often contribute to capital campaigns. Some national chains—such as Home Depot, Lowe's, Walmart, and Target—have small community grants programs in certain areas of the country. Both large and small businesses might even provide construction materials at a reduced cost or donate furnishings or equipment. If businesses ultimately donate to your effort, they will appreciate any public recognition you can give them for their generosity—which will then incline them to contribute again to any future effort.

### Tax credit programs

Many states also have tax credit programs designed to benefit nonprofit organizations. Frequently referred to as **Neighborhood Assistance Programs**, these tax credit programs allow businesses (and in some states, individuals as well) to receive a tax credit for donations to specific nonprofit organizations. In many cases Head Start grantees are eligible to receive donations through this program. These tax credit programs are typically administered by the state's department of economic development, social services, or revenue. They vary from state to state, but in most cases a tax credit produces a greater tax benefit for a corporate donor than a charitable deduction.



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A tax credit often produces a greater tax benefit for a for-profit corporation than a charitable deduction.

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### Community Service Organization

Many business leaders actively participate in local community service organizations, such as Kiwanis, Lions, and Rotary clubs. These organizations sometimes adopt community projects to support and help raise money or provide volunteers. Early Care and Education directors may even want to consider joining one of these civic organizations as a way to network with local business people, thus establishing connections that could lead to opportunities for securing financial gifts or identifying potential board members.



Consider joining local civic organizations as a way to network with local business people and to establish connections that could lead to opportunities for securing financial gifts or identifying potential board members.

### Community Service Projects

Finally, many corporations organize community service projects for their employees. These initiatives provide favorable public relations for firms, enable the corporation to win recognition for good corporate citizenship, and offer employees a rewarding team-building experience. In-kind volunteer labor of this type can produce modest savings on discrete tasks that require relatively unskilled labor, such as playground installation, landscaping, and painting.

### Individuals

Individual donations represent about 80 percent of all philanthropic giving in the United States and are an attractive source of funding for capital projects. If your organization has solicited donations from community members each year to support your work, you already have a base of prospective individual donors upon which to build your capital campaign.

Traditionally, an organization's appeal for annual giving seeks contributions to support the organization's programmatic activities. A capital campaign, however, is different in that it pursues significant, one-time gifts from donors' accumulated assets. As a result, you'll want to focus your fundraising efforts on wealthy individuals—people with high net worth. These are the people who have the capacity to give generously, and they will be more inclined to do so if they share your organization's passion about working with low-income children and families. Early Care and Education leaders should think specifically about cultivating relationships with those business leaders who have personal wealth, community prominence, and personal



networks. Ideally—and well before any capital campaign—Early Care and Education leaders will have already cultivated these individuals as organizational “friends” through annual giving appeals, professional organizations and connections, or regular fundraising events. This strategy also means carefully crafting an individualized and personal solicitation (see more under [Capital Campaigns](#)).



### Using Multiple Sources of Funding

To attract enough money for a facility project, Head Start grantees need to be creative in identifying funding sources and in developing their fundraising strategy. The Laconia Lakes Region Family Center assembled a financing package that illustrates the imaginative, multi-source financing model that many Head Start grantees resort to—and that highlights their bold decision to attract funders by proposing a more ambitious concept.

After purchasing a new site, the Community Action Program (CAP) of Belknap-Merrimack Counties, Inc., in central New Hampshire decided to build more than just a center with Head Start classrooms. CAP decided instead to develop a 20,000-square-foot community center that would house multiple services aimed at low-income families with young children, such as prenatal services, family planning, WIC (Women, Infants, and Children), and other community action program services, including fuel assistance—in effect, a single place that would provide comprehensive services to children and families. CAP’s leaders believed that this expanded vision would be more attractive to funders—and would attract more funders.

Many sources of grants and loans formed the layered financing plan for the new center. The expected sources included a Head Start acquisition and construction grant, a U.S. Department of Agriculture Community Facilities grant, Community Development Block Grant funds, and private bank financing. However, the CAP was also inventive in tapping other sources that are easy to dismiss or overlook:

- **Private Foundations:** Since it didn’t have any large philanthropic foundations from which to solicit funds, the CAP conducted research that produced a long list of very small foundations. To make the fundraising effort worthwhile and less time consuming, the CAP generated a proposal template that required minimal effort to tailor each request to the interest of a specific foundation. This enabled the CAP to submit 35 proposals. The effort paid off. It yielded \$100,000 in grants.



- **Energy Efficiency Grants:** States and utility companies offer a wide range of loans, cash, and in-kind grants for using energy-efficient systems and fixtures. All of these can be easily located by accessing the [Database of State Incentives for Renewables and Efficiency](#). The CAP received a grant for lighting.

### Capital Campaigns

In some respects, an Early Care and Education program’s overall efforts to attract grants and donations for a facility project can be thought of as a capital campaign. However, the term “capital campaign” usually refers to a broad public solicitation of funds for a capital project.

#### Typical Capital Campaigns

Capital campaigns conventionally follow an established framework. They start with an **initial “quiet” phase:**

- » Major commitments are sought early in the process; the organization’s executive director and volunteer leadership, including board members, meet face-to-face with potential donors. Roughly 60 percent of the total target is raised from 15 or 20 “top” contributors.

- The very top gifts are between 10 and 15 percent of the total.
- The typical sources of the major gifts come from foundations, government agencies and programs, and generous individuals.

Once the quiet phase has succeeded in meeting approximately 50 percent of the campaign target, the campaign moves into the **“public” phase:**

- The public phase broadens the fundraising drive to attract numerous smaller donors.
- The public phase is usually marked by a press conference, mailings, and special events.

#### Capital Campaigns for Early Care and Education programs

The traditional capital campaign described above can be challenging for small non-profits or for an organization that does not have an established fundraising network or ready, deep-pocketed donors. To carry out a successful campaign, a nonprofit organization ideally should plan to hire a seasoned capital campaign consultant and invest significant time and money in the process. However, if you can’t afford a professional, you may still be able to raise funds by using board members or a group of committed parents who have the skills to launch a grassroots campaign. The possibility is worth exploring if there are no other options.





Specific federal policies restrict the use of Head Start resources for fundraising purposes. Therefore, other allowable funding sources would need to cover the time that an executive director spends on any fundraising activity.

Before embarking on a capital campaign, the organization should make an honest assessment of whether it is well positioned to succeed: Does the organization have an existing and committed base of donors to its annual fund? Does it have relationships with people who know and will solicit businesses and individuals of high net worth for the benefit of the proposed project? Also, since federal Head Start funds cannot be used to hire fundraising consultants, for Head Start programs an alternative funding source is needed to cover these and other fundraising expenses.



Organizations that are committed to carrying out a capital campaign face three major tasks:

**1. Developing a compelling case and presentation.** The organization needs to make a compelling case for its early care and education facility that appeals to the interests and concerns of foundations or wealthy individuals. As part of that case, it needs to be able to answer the following questions about the project:

- » Why is it important?
- » What difference will it make?
- » Will it be successful?

Organizations should start by preparing a concise written statement that describes the project and the campaign and that (ideally) includes an architectural rendering or other visual representation of the new center to generate interest. Key staff members should be able to convey this information in a concise statement during key meetings with potential supporters.

**2. Identifying and getting access to prospective donors.** In most cases an organization will need to tap other peoples' networks of friends and associates in order to secure a sufficient base of donors. A few dedicated and motivated volunteers who have the right relationships can bring these networks to a capital campaign and begin to build a donor base. In addition to resulting in a new facility, one of the lasting benefits of a capital campaign, when done properly, is a donor base that can be an ongoing source of supplemental revenue and perhaps major donors to a future capital campaign.



### 3. Building the organizational resources to establish and cultivate relationships with donors.

- » **Staff and consulting time.** Cultivating leaders among your volunteers and building relationships with donors requires a great deal of time. Most organizations venturing into a capital campaign need a fundraising consultant. In some cases, capital campaign consultants plan and staff the effort, which is expensive. More frequently, smaller organizations use “fundraising counsel”—a consultant who advises and coaches on an hourly or part-time basis. Since a program’s executive director most likely will be spending a lot of time cultivating contacts and making requests, other staff may have to take over certain responsibilities within the organization. However, keep in mind that there are specific federal policies that restrict the use of Head Start resources for fundraising purposes. Therefore, other allowable funding sources would need to cover the time that the executive director spends on any fundraising activity.
- » **Tracking system.** Organizations carrying out a capital campaign should invest in good fundraising database software to help manage the tasks of tracking communications with multiple donors. Since donors can continue to provide support in the future, they should be thanked promptly and kept informed of progress on the project. A number of free or inexpensive programs are available for nonprofit organizations. Conducting a little research to find the software that fits your program’s funding profile will go a long way toward insuring the success of your efforts. A good place to start is at <http://idealware.org/articles/few-good-donor-management-systems>. Since this software involves only your fundraising efforts, you cannot use federal funds to purchase such a system.



A good source of fundraising information for small nonprofits is the **Grassroots Fundraising Journal**. Reprints of a series of articles on capital campaigns by Kim Klein are available through the journal’s website at [www.grassrootsfundraising.org](http://www.grassrootsfundraising.org).



# ESTIMATING FUTURE OCCUPANCY EXPENSES



As you carry out your facility project, the capital budget will probably be your major focus. However it is equally important to be able to present a viable operating budget that anticipates facility-related occupancy costs in addition to program-related expenses. Even if you can raise the necessary capital, you need to know that your program or organization will have enough annual income to cover ongoing occupancy costs. You must be able to address this concern for two reasons:

1. You never want to move into a facility only to later discover you can't afford it.
2. If you are seeking a loan, your lender will require a projected operating budget that includes your occupancy costs in the new facility. This requirement is part of the standard loan-approval process. The lender will carefully analyze this projected budget and the assumptions behind it to assess your ability to repay the loan.

Also, remember that you must be able to demonstrate that it is more cost-effective to purchase, construct, or renovate a facility than to lease space. Thus you must be able to quantify ongoing occupancy costs.

## How a New Facility Can Impact Operating Budgets

A new facility can impact a program's operating budget in many ways. You'll want to consider the following questions as you project these expenses:

- **Income.** How will the new facility affect program income? Will the grantee serve more children or fewer? Will the ages of children be the same or different? Will there be income from tenants in the building?
- **Expenses.** Will the configuration of the new space enable the grantee to staff its program more efficiently? Will you have a commercial kitchen in the new facility that will enable you to prepare meals on site rather than have them catered? Will transportation costs increase or decrease?



Along with income and expenses, you'll especially want to consider ongoing occupancy costs in your new facility, keeping in mind that many facility-related expenses vary with the building's size, financing, and energy-efficiency, among other things. Also, since a multiyear operating budget will be needed, grantees should make projections about the rate at which income and expenses are likely to rise over the years. The sample occupancy budget template below is followed by a discussion of how to estimate expenses for major occupancy expense items:



SAMPLE OCCUPANCY BUDGET					
OCCUPANCY EXPENSES	Year 1	Year 2	Year 3	Year 4	Year 5
Depreciation	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
Mortgage or Rental Payments	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
Utilities (gas, electric, water and sewer)	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
Insurance	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
Maintenance and Repair (Janitorial, Landscaping, Snow Removal, etc.)	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
Taxes	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
Replacement Reserve	\$ _____	\$ _____	\$ _____	\$ _____	\$ _____
<b>TOTAL OCCUPANCY EXPENSES</b>	<b>\$ _____</b>				

### How to Estimate Occupancy Expenses

- Depreciation.** If your previous space was rented, you may not be familiar with the issues related to depreciation. As any building ages it wears out and therefore loses some of its value each year. Although it is not a cash outlay, depreciation does represent some degree of financial loss. For example, if a building is expected to last for forty years, it loses one fortieth of its value each year. Depreciation is the accounting procedure that reflects this loss of value. To estimate depreciation expenses, you'll want to consult your accountant.
- Mortgage or Rental Payments.** These are generally the largest, most obvious, and most straight-forward costs to estimate. Mortgage payments are fixed for the term of the loan. However, it is not uncommon for a lease agreement to contain escalator clauses that provide for annual increases in rent and other property-related expenses, such as taxes. Review your lease carefully to determine what your liability will be each year during the term of the lease.
- Utilities.** If a facility is owned—and often even when rented—the occupant pays for the use of electricity, gas, fuel oil, water, and telephone. Future utility expenses are usually estimated on a per-square-foot basis. Contact your utility companies for advice about these kinds of annual costs.



- **Property/Liability Insurance.** If your organization owns the facility, you will insure it so that it is covered in the event of unforeseen losses due to fire, lightning, vandalism, etc., and against civil damages arising from injuries occurring on the property. This insurance represents an additional expense. Consult with your insurance broker to develop an estimate for this expense.
- **Maintenance and Repair.** Since buildings include many specialized systems, their maintenance is often handled through service contracts. This makes estimating the costs relatively easy. Typically, service contracts can be secured for heating, ventilation, and air conditioning (HVAC); pest control; fire alarm and sprinkler systems; and janitorial, landscaping, and snow-removal services. To project these annual expenses, you simply need to look at past accounting records (to determine trends) and current service contracts.
- **Taxes.** Sometimes, as a nonprofit organization, the early care and education organization that owns a property is exempt from paying property taxes. However, when that is not the case, the occupancy budget should include an allowance for tax payments. Also, if the program is located in rented space, many commercial lease agreements include a tax escalation clause requiring tenants to pay their pro-rated share of any increase in the owner's property tax liability. In both cases the local municipality should be able to help you estimate your tax bill.
- **Replacement Reserve.** Since depreciation is the accounting process for recognizing the impact of normal wear and tear on a building, property owners should also maintain a reserve to replace the building systems as they wear out. One way to do this is to make a practice of annually setting aside a portion of the organization's unrestricted net assets equivalent to the cumulative depreciation so that funds are available over time to replace capital equipment, such as the HVAC and the roof.



For organizations that include a facilities or property manager on their staff, the relevant payroll expenses will need to be included in the operating budget.



## MOVING FORWARD

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While no one will tell you that raising the money you need for a new or renovated early care and education facility is going to be easy, neither will anyone tell you it's impossible. As with most large ventures, if you break the process down into small steps and take them one at a time, each step can become manageable. In addition, through the process of finding the money you need—which will involve meeting new people, learning more about your community, mastering new skills, and gaining new information—your world will become larger. And of course you will have achieved your goal of developing a wonderful home away from home for the children you serve and the staff you employ.

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